

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03
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FM AMEMBASSY LIMA
TO SECSTATE WASHDC IMMEDIATE 1154

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 6679

E.O. 11652: GDS
TAGS: EFIN PE
SUBJ: PERU'S IMF STAND BY

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1. SUMMARY: THE GOP AND IMF HAVE REACHED BASIC AGREEMENT ON A STANDBY ARRANGEMENT. CENTRAL BANK AND FINANCE MINISTRY OFFICIALS HAVE TOLD US THAT DRAFT AGREEMENT HAS BEEN TAKEN TO WASHINGTON FOR IMF STAFF REVIEW, AND GOP CABINET CONSIDERATION, WHERE NO PROBLEMS ARE FORESEEN, IS ANTICIPATED FOR AUGUST 1. AGREEMENT, WHICH WILL BE FOR APPROXIMATELY \$210 MILLION, WILL BE DISBURSED IN ROUGHLY 10 QUARTERLY TRANCHES BEGINNING OCTOBER 1 AND RUNNING THROUGH 1980. PRINCIPAL 1978 TARGETS ARE A S/65 BILLION CENTRAL GOVERNMENT DEFICIT, A 195/\$ EXCHANGE RATE BY YEAR END, AND A \$240 MILLION NET LOSS IN INTERNATIONAL RESERVES. IMPLICIT IN THE AGREEMENT IS A PROJECTED INFLATION RATE OF 60-70 PERCENT AND A MINUS 1.8 PERCENT GROWTH RATE FOR 1978. 1979 TARGETS ARE NOT EXPLICIT IN THE AGREEMENT. WHILE IMPLEMENTATION OF THE AGREEMENT WILL BE A FORMIDABLE TASK FOR THE GOP, A COHERENT STRATEGY FOR STABILIZATION AND RECOVERY IS TAKING SHAPE AND THE ECONOMIC TEAM DESERVES A CHANCE TO CARRY OUT ITS PROGRAM.
END SUMMARY.

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2. STATUS OF IMF AGREEMENT. ACCORDING TO ALONSO POLAR, GENERAL MANAGER OF CENTRAL BANK, IMF MISSION TOOK A DRAFT LETTER OF INTENT (AGREEMENT) TO WASHINGTON AND POLAR EXPECTS TO RECEIVE A TELEX BACK FROM IMF HEAD JACQUES DE LAROSIERE CONFIRMING IMF STAFF ACCEPTANCE OF AGREEMENT. POLAR EXPECTS APPROVAL BY IMF MANAGEMENT BEFORE AUGUST 15 AND APPROVAL BY IMF BOARD OF DIRECTORS BY SEPTEMBER 15. ACCORDING

TO FELIPE REATEGUI, ADVISOR TO CENTRAL BANK PRESIDENT (WHO CAUTIONED HE WAS SPEAKING OFF THE RECORD), THERE ARE A FEW REMAINING ADJUSTMENTS BEING MADE ON THE TEXT BY CENTRAL BANK STAFF BUT ALL ESSENTIAL POINTS HAVE BEEN SETTLED. GOP ADVISOR TO FINANCE MINISTER TOLD US CABINET REVIEW IS ANTICIPATED FOR AUGUST 1 AND NO PROBLEMS ARE EXPECTED.

3. MECHANICS OF IMF AGREEMENT. REATEGUI SAID STANDBY AGREEMENT IS FOR SDR 184 MILLION (ABOUT \$210 MILLION), IS TO LAST THROUGH 1980, AND CONSISTS OF TEN TRANCHE RELEASES WITH THE FIRST TRANCHE TO BE AVAILABLE AS OF OCTOBER 1, 1978 WITHOUT FURTHER IMF REVIEW. IN MID NOVEMBER AN IMF TEAM IS TO RETURN TO LIMA FOR A REVIEW, FOLLOWING WHICH PERU WOULD BE ELIGIBLE FOR SECOND TRANCHE RELEASE ABOUT DECEMBER 1. SUBSEQUENT TRANCHE RELEASES ARE TO BE EVERY THREE MONTHS. THE FIRST NINE TRANCHES ARE IN AMOUNT OF SDR 18 MILLION EACH AND THE FINAL TRANCHE IS SDR 22 MILLION. IN ADDITION THE IMF IS SENDING EXPERT TO CONFIRM PROVISION OF UP TO SDR 61.5 MILLION UNDER THE EXPORT COMPENSATION FUND, DUE TO POOR PRICES OF PERU'S MAIN EXPORTS. CHIEF OF CENTRAL BANK ECONOMIC RESEARCH CONFIRMS THAT RELEASE OF THIS CREDIT IS IN ADDITION TO TRANCHE RELEASES UNDER STANDBY AGREEMENT. HE ALSO STATED ABOUT SDR 20 MILLION OF THIS CREDIT COULD BE MADE AVAILABLE WITHOUT APPROVAL OF IMF BOARD OF DIRECTORS BUT THAT THE REMAINDER WOULD REQUIRE SUCH APPROVAL. FOR THIS REASON THE REMAINDER (WHICH MIGHT BE MORE OR LESS THAN SDR 40 MILLION) WOULD PROBABLY NOT BE AVAILABLE UNTIL FIRST TRANCHE RELEASE.

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ABLE UNTIL FIRST TRANCHE RELEASE.

4. TARGETS FOR 1978. ACCORDING TO REATEGUI (AGAIN, OFF THE RECORD) PRINCIPAL TARGETS FOR 1978 ARE A NET LOSS IN INTERNATIONAL RESERVES OF \$240 MILLION, BANKING SYSTEM NET CREDIT TO THE PUBLIC SECTOR OF S/88.6 BILLION, AND A YEAR END OFFICIAL EXCHANGE RATE OF S/195 PER U.S. DOLLAR. (HE CAUTIONED THAT THERE MAY BE FURTHER SLIGHT ADJUSTMENTS IN FIGURES.) IMPLICIT IN THE AGREEMENT IS A DECEMBER 1977-DECEMBER 1978 INFLATION RATE OF 60-70 PERCENT AND A NEGATIVE GROWTH RATE OF 1.8 PERCENT. IN REGARD TO THE CENTRAL GOVERNMENT DEFICIT, THE NET DOMESTIC DEFICIT FOR 1978 IS S/79.5 BILLION AND NET BANKING SYSTEM FINANCING OF THIS DEFICIT IS S/72.9 BILLION. ACCORDING TO THE JULY ISSUE OF THE ANDEAN REPORT, RELEASED JULY 25, PETROPERU'S CASH FLOW DEFICIT FOR 1978 IS PROJECTED AT S/12 BILLION. REATEGUI ALSO NOTED CENTRAL GOVERNMENT EXPENDITURE PROJECTION INCLUDING A GENERAL PUBLIC SECTOR WAGE INCREASE OF S/2000 PER WORKER TO BE GRANTED IN OCTOBER AND A S/5000 PER TEACHER WAGE INCREASE DURING THE SECOND HALF OF 1978. (COMMENT: THIS IS THE FIRST CONCRETE NEWS WE HAVE THAT THE GOP PLANS TO MAKE A SIGNIFICANT ECONOMIC CONCESSION TO RESOLVE THE TWO MONTH OLD TEACHERS STRIKE.)

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C O N F I D E N T I A L SECTION 2 OF 2 LIMA 6679

5. PROJECTIONS FOR 1979. THE TARGETS FOR 1979 ARE NOT
EXPLICIT IN THE STANDBY. POLAR STATED HE EXPECTS 40 TO 50 PERCENT
INFLATION FOR 1979, A NEAR ZERO GROWTH FOR THE PERUVIAN ECONOMY
AND ABOUT A \$300 MILLION B/P GAP. HE ALSO STATED THAT PETROPERU
HAS A LARGE PROJECTED DEFICIT FOR 1979 (\$60 BILLION
ACCORDING TO ANDEAN REPORT) AND THAT PETROLEUM PRICES WILL BE
INCREASED TO REDUCE OR ELIMINATE THIS DEFICIT. PPOLAR ALSO
NOTED THAT A WORLD BANK PROGRAM LOAN IN 1979 OF ABOUT
\$100 MILLION IS INCLUDED IN THE PROJECTIONS MADE FOR THE STANDBY.

6. HIGHER INTEREST RATES. THE CENTRAL BANK PUBLISHED NEW
HIGHER INTEREST RATES FOR BANKING SYSTEM CREDITS AND DEPOSITS
TO TAKE EFFECT ON AUGUST 1. THE PRIME COMMERCIAL BANK INTEREST
RATE IS INCREASED FROM THE PRESENT 17.5 PERCENT TO 27.5 PER-
CENT PER ANNUM. INTEREST RATES ON TIME DEPOSITS ARE
INCREASED BY 12 PERCENTAGE POINTS WITH DEPOSITS 90 TO 179
DAYS TO 25.0 PERCENT PER ANNUM RANGING UPWARDS TO 31.0
PERCENT PER ANNUM FOR DEPOSITS WITH TERMS IN EXCESS OF 1,079
DAYS (I.E. 3 YEARS). TAX FREE BONDS ISSUED BY VARIOUS
PUBLIC SECTOR INSTITUTIONS WILL BRING HIGH BRACKET TAX
PAYERS EFFECTIVE YIELD IN EXCESS OF 40 PERCENT PER ANNUM.

8. COMMENT: POLAR'S FIRST COMMENT TO US WAS THAT THE
ISSUE IS NOT AGREEMENT ON STANDBY TARGETS BUT THEIR IMPLEMEN-
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TATION. THIS IS CERTAINLY THE CASE. AT FIRST BLUSH THERE ARE SOME MORE HOPEFUL SIGNS THIS TIME AROUND THAN WITH THE PREVIOUS TWO IMF AGREEMENTS (ONE OF WHICH NEVER PASSED THE COUNCIL OF MINISTERS) THAT FAILED TO BE IMPLEMENTED. THE NEW ECONOMIC TEAM IS HIGHLY COMPETENT AND APPARENTLY HAS THE CONFIDENCE OF THE PRESIDENT. THE TARGETS ON INFLATION AND THE EXCHANGE RATE APPEAR REASONABLE. THE SQUEEZE ON THE ECONOMY DURING THE PAST YEAR HAS BROUGHT THE TRADE ACCOUNT INTO BALANCE AND AT LEAST SETS THE STAGE FOR STIMULATION OF THE INVESTMENT SECTOR. BUT THE HURDLES AHEAD ARE EQUALLY FORMIDABLE. THE 80 BILLION SOLES TARGET FOR THE CENTRAL GOVERNMENT BUDGET DEFICIT THIS YEAR APPEARS TO IMPLY FURTHER SPENDING CUTS OF SOME 20-30 BILLION SOLES WHICH WILL BE A MAJOR BATTLE FOR THE FINANCE MINISTER WITH HIS CABINET COLLEAGUES. THERE WILL BE A CONTINUAL STRUGGLE TO HOLD BACK WAGE INCREASES AND TO INCREASE ADMINISTERED PRICES (PARTICULARLY GASOLINE AND TRANSPORTATION) IN THE FACE OF STRONG SOCIAL PRESSURES. AND THE POLITICAL RELATIONSHIP BETWEEN THE NEWLY ELECTED CONSTITUENT ASSEMBLY AND THE GOVERNMENT COULD FURTHER COMPLICATE THE LINES OF AUTHORITY AND DECISION-MAKING. NEVERTHELESS, A COHERENT STRATEGY FOR STABILIZATION AND RECOVERY IS TAKING SHAPE, INCLUDING THE MEDIM TERM POLICY OBJECTIVES IMPLICIT IN DISCUSSION OF A WORLD BANK PROGRAM LOAN. (WORK IS UNDERWAY IN BOTH THE CENTRAL BANK AND THE FINANCE MINISTRY ON THIS.) WE NEED TO GIVE THIS ECONOMIC TEAM A CHANCE AND TAKE THEM AT THEIR WORD THAT IT IS THE IMPLEMENTATION OF THE STANDBY THAT WILL BE THE TEST. SHLAUDEMAN

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